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MICHAEL RODAK, JR.,

IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-651

ALVIN H. BERNDT, ROBERT S. DRISCOLL and LORD, ABBETT & CO.,
Petitioners,

v.

PAULETTE PAPILSKY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JUDSON A. PARSONS, JR.
Attorney for Petitioners
140 Broadway
New York, New York 10005
Phone: (212) 344-8000

KEITH E. MCCLINTOCK
PATRICIA N. COLLOTON
DEWEY, BALLANTINE, BUSHBY,
PALMER & WOOD
Of Counsel.

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Alvin H. Berndt, Robert S. Driscoll and Lord, Abbett & Co., defendants-appellants below, petition for a Writ of Certiorari to review a judgment of the Court of Appeals for the Second Circuit dated and entered on August 1, 1972. (A30)

Opinions Below

The opinion of the District Court for the Southern District of New York (A5-A11) is reported at 333 F. Supp. 1084. The opinion of the Court of Appeals for the Second Circuit (A12-A29) has not yet been reported.

Jurisdiction

The District Court's jurisdiction was based upon the Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.*, the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 *et seq.*, and the Securities Exchange Act of 1934, 15 U.S.C. § 78(a) *et seq.* The jurisdiction of the Court of Appeals was based on 28 U.S.C. § 1292(b), that court having accepted a certification from the District Court. This Court's jurisdiction is based upon 28 U.S.C. § 1254(1).

Question Presented

Whether before trial a shareholder derivative action or other class action may be finally adjudicated for the defendants on a contested issue going to the merits so as to bind absent class members who are not given notice of the proposed adjudication.

Statute and Rules Involved

28 U.S.C. § 2072, 62 Stat. 961 as amended, present Fed. R. Civ. P., Rules 23(e), 23.1, 41(a) and 41(b), 28 U.S.C. (1970) and former Fed. R. Civ. P., Rule 23(c), 28 U.S.C. (1938) are set forth at pp. A1-A4 of the Appendix hereto.

Statement of the Case

This is a stockholders' derivative action brought by respondent Paulette Papilsky ("Papilsky"), a shareholder of Affiliated Fund, Inc. ("Fund"). The Fund is an open-end investment company. Petitioner Lord, Abbett & Co. ("Lord, Abbett") is the Fund's investment adviser and principal underwriter. Petitioners Driscoll and Berndt are partners in Lord, Abbett and officers and directors of the Fund. (A13)

The complaint contains general allegations to the effect that petitioners failed to recapture and to credit the Fund with allegedly recapturable portions of brokerage commissions paid on the Fund's portfolio transactions in the form

of "give ups" and "reciprocals" all in violation of various provisions of the Securities Exchange Act of 1934, the Investment Company Act of 1940 and the Investment Advisers Act of 1940. (A5, A13 and A14)

Following service of the complaint, petitioners moved for summary judgment on the ground that the action is barred by *res judicata*. That motion, which is the subject of the present petition, is based on the earlier dismissal of a previous stockholders' derivative action brought on behalf of the Fund against petitioners and others, *White and Bernstein* v. *Driscoll, et al.*, S.D.N.Y. 67 Civ. 98 ("*White*").* It is undisputed that the causes of action in *White* are identical to those alleged in the present case. (A6, A14)

A. The *White* Case

White was a consolidation of two separate stockholders' derivative actions.** On January 14, 1969 the District Court ordered that White answer a number of interrogatories by February 15, 1969 (which deadline was later extended to March 4, 1969), that petitioners produce a number of documents on the same date and that White's proposed depositions of petitioners be deferred until after this exchange. The complaint in *White* (like the complaint here) was vague and did not specify the precise acts of petitioners which were alleged to violate the law. The interrogatories which White was required to answer called upon her to particularize these generalizations. (A15)

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* All of the petitioners in the present case were served with process as defendants in *White*, except petitioner Berndt, who was not served and did not appear in *White*. However, Berndt, a partner of Lord, Abbett & Co. (A13), was exposed to liability in *White* through the partnership and is entitled to the same *res judicata* benefits as Lord, Abbett. *Goldstein* v. *Doft*, 236 F. Supp. 730, 733 (S.D.N.Y. 1964), *aff'd per curiam* 353 F.2d 484 (2d Cir. 1965), *cert. denied*, 383 U.S. 960 (1966).

** The two shareholder plaintiffs in *White* are hereinafter collectively referred to as "White".

White made her first attempt to answer the interrogatories in May 1970. However, petitioners returned these purported answers on the grounds that they were unverified and insufficient. In December 1970 White made her second attempt, serving 28 pages of answers upon petitioners. (A15) At the same time, petitioners produced over 1,300 pages of documents.

Thereafter petitioners moved that the action be dismissed on the ground that White's answers were not the full and complete answers required by the District Court's order. (A15) Petitioners' basic position was that the answers failed to specify their alleged wrongful acts and that this failure demonstrated that White had no case. The motion was opposed by White (A15), whose counsel filed a lengthy affidavit which attempted to correct any deficiencies contained in the answers and which stated that White could not and should not be expected to provide more specific answers prior to further discovery of petitioners. This affidavit was filed approximately two months after petitioners' documents had been produced.

The motion was first referred to a Special Master who recommended that the case be dismissed. Judge Wyatt agreed and on March 16, 1971 entered an order, and on March 22, 1971 entered a judgment, dismissing the action as to petitioners. No notice was given to absent shareholders of the proposed order or judgment. Neither the judgment nor the order specified that the dismissal was without prejudice.* (A15, A16)

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* Because the *White* action was allegedly brought on the Fund's behalf, the Fund was only a nominal defendant and it did not join in petitioners' motion to dismiss. After the dismissal with respect to petitioners, which did not formally dismiss as to the Fund, the action remained on the docket but was no longer viable because the Fund was the only remaining defendant which had been served. On June 12, 1971 the court entered a routine calendar order of dismissal with respect to the Fund which was stated to be without prejudice. (A16) This order had no application to petitioners since they were already out of the case at the time it was entered.

It is undisputed that White's opposition to the motion to dismiss was vigorous. Respondent has never suggested that the motion was improperly decided or that anything could have been done to oppose it that was not done.

In *White*, counsel for petitioners took depositions of both plaintiffs, interviewed potential witnesses, reviewed thousands of documents in petitioners' files and performed a wide variety of other tasks in preparation of the defense of the action on the merits.

B. The District Court Proceedings in the Present Case

In denying petitioners' motion to dismiss in the present case, Judge Wyatt primarily relied upon a conceptual analysis of the nature of a derivative suit which was later rejected by the Court of Appeals. Judge Wyatt referred to petitioners' "impressive amount of preparation" in *White* (A11) and said that although he was inclined to believe that notice to the shareholders had been required in *White* by Rule 23.1, Fed. R. Civ. P., he would assume for purposes of the motion that it had not been required (A9).

He also suggested that the possibility of fraud in future cases was a reason for denying the motion, but flatly stated that no fraud had been involved in his previous *White* dismissal:

> "There is not the slightest suggestion of any impropriety in the motions to dismiss and in the dismissal of the White action; the Court at the time was fully advised in the premises." (A10)

Judge Wyatt recognized the importance of the question presented by petitioners' motion and *sua sponte* included in his opinion a certification that the case was an appropriate one for interlocutory appeal pursuant to 28 U.S.C. § 1292(b) (A11).

C. The Court of Appeals Opinion

The Court of Appeals accepted Judge Wyatt's certification and affirmed. It rejected Judge Wyatt's conceptual analysis of a derivative suit (A17-A21).

The Court of Appeals recognized that in an ordinary case the *White* dismissal would operate as an adjudication on the merits pursuant to Rule 41(b), Fed. R. Civ. P., because no statement to the contrary appeared in the order.

The court admitted that its decision "carves out an exception" to Rule 41(b) and held that *White* was "more analogous" to an unopposed dismissal before trial than to a dismissal after a hearing on the merits and that "on balance" notice should have been given. It therefore sustained respondent's collateral attack on the *White* judgment (A26).

Although the possibility of fraudulent dismissals in other cases was stated as a policy reason in support of the court's decision, the court was careful to point out that:

> "We do not suggest that in the instant case there was any collusion between the *White* plaintiffs and the defendants." (A27)

It also quoted Judge Wyatt's statement on this subject (A27).

Reasons for Granting the Writ

THE DECISION OF THE COURT BELOW,

(A) DECIDED ERRONEOUSLY AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT,

(B) CONFLICTS WITH THE FEDERAL RULES OF CIVIL PROCEDURE AND GENERAL PRINCIPLES ESTABLISHED IN APPLICABLE DECISIONS OF THIS COURT AND OTHER FEDERAL COURTS, AND

(C) IF NOT CORRECTED PROMPTLY, IS LIKELY TO CAUSE A SUBSTANTIAL WASTE OF JUDICIAL EFFORT.

This case arises out of an important misapplication of the last sentence of Rule 23.1, Fed. R. Civ. P., which deals with when notice of a proposed dismissal or compromise must be given to shareholders in a derivative suit. But the significance of this case is not limited to derivative suits, by themselves an important area of federal jurisprudence. The language from Rule 23.1 relied on by the lower court is identical to the language contained in Rule 23(e) which states when notice of a proposed dismissal or compromise must be given to absent class members in other types of class actions (A1, A2). Consequently, if allowed to stand, the decision below will apply in all types of class actions.

No problem confronting the federal judiciary is more important or more pressing than the problem of dealing effectively with the ever growing mass of class litigation now burdening the courts. And in such litigation no problem is more important than how to proceed to insure that the result will bind absent class members and keep the whole controversy from being litigated over and over again.

The issue in this case is whether notice of a proposed involuntary, pretrial dismissal going to the merits must be given to absent class members in order to bind them. This is important to any judge who believes as a result of pretrial proceedings that plaintiff is not entitled to a trial and who wishes to avoid the protracted trials common in such cases.

It is also an issue full of pitfalls for the judge. If he erroneously decides not to give notice he may find that his efforts in the case have been wasted because the absent class members are allowed to litigate the same controversy all over again.

If on the other hand he errs on the side of caution and requires an unnecessary notice, he may also be causing a substantial waste of judicial effort. The notice procedure frequently is extremely expensive, cumbersome and time-consuming. For example substantial judicial effort may be consumed in determining who should pay for the notice, what it should contain, how it should be distributed, and in dealing with the responses to it, many of which may be of little, if any, assistance to the court.* As the court said in *School District of Philadelphia* v. *Harper & Row Publishers, Inc.*, 267 F. Supp. 1001, 1005 (E.D. Pa. 1967):

> "... Observation and long experience have taught us that the mere service of notice upon the hundreds who would be involved is far more likely to be the beginning, rather than the end, of frustrating complexities...."

The following remark by a special committee of the American College of Trial Lawyers is also pertinent:

> "... Where the alleged class consists of tens of thousands the burden and cost of preparing and mail-

*For a comprehensive discussion of the problems encountered in giving notice in a class action, see *Eisen* v. *Carlisle & Jacquelin*, 52 F.R.D. 253, 265-276 (S.D.N.Y. 1971).

ing notices, responding to inquiries, and tabulating returns would surely exhaust the budget of any district. . . ."*

The rule concerning when notice is necessary ought to be as clear as possible so as to avoid this judicial waste. Heretofore the law in this area had been reasonably clear under the previously accepted voluntary-involuntary standard described below. However, the erroneous decision of the Court of Appeals has changed all this by introducing a confusing new "more analogous" standard which will be difficult to follow and which, unless corrected by this Court, is bound to lead to a substantial waste of judicial effort at a time when it can least be afforded.

In considering the effect of *White* it is important to keep in mind the underlying reason for the dismissal. Petitioners argued in *White* that her three failures to particularize the conclusory allegations contained in her complaint revealed that she had no case. It was proper for the court to infer from White's failures that there was no evidence to support her general allegations. *Societe Internationale* v. *Rogers,* 357 U.S. 197, 209, 210 (1958); *Hammond Packing Co.* v. *Arkansas,* 212 U.S. 322, 346-354 (1909).

There is no reason for assuming that Judge Wyatt dismissed on any other basis. For example, his dismissal was not entered to punish White. Under this Court's explicit holding in *Hovey* v. *Elliott,* 167 U.S. 409 (1897), it would have been a violation of due process for him to have dismissed for any such purpose. Since respondent has made no claim, and since there is no basis for assuming, that Judge Wyatt's dismissal was improper, it must be concluded that it was a dismissal on the merits—similar to a dismissal at trial for failure to prove a case.

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* American College of Trial Lawyers, Report and Recommendations of the Special Committee on Rule 23 of the Federal Rules of Civil Procedure, at p. 12 (March 15, 1972).

Since 1938 the key to when such an involutary dismissal in a derivative or other class action binds absent class members has been Rule 41 of the Federal Rules of Civil Procedure and its distinction between voluntary and involuntary dismissals.

Rule 41(a) applies to voluntary dismissals and provides that such dismissals are "without prejudice" unless the judgment states the contrary. (A2, A3)

Rule 41(b), on the other hand, applies to involuntary dismissals and states in pertinent part:

> "(b) **Involuntary Dismissal: Effect Thereof.** *For failure of the plaintiff to prosecute or to comply with these rules or any order of court, a defendant may move for dismissal of an action or of any claim against him. . . . Unless the court in its order for dismissal otherwise specifies, a dismissal under this subdivision and any dismissal not provided for in this rule,* other than a dismissal for lack of jurisdiction, for improper venue, or for failure to join a party under Rule 19, *operates as an adjudication upon the merits.*" (emphasis added) (A3, A4)

The dismissal in *White*—which was vigorously opposed by plaintiff—was clearly involuntary. It was a dismissal on the merits for failure to obey a court order. It may also be viewed as a dismissal for failure to comply with the Federal Rules of Civil Procedure relating to discovery. The order of dismissal said nothing to suggest that the case was dismissed without prejudice. Therefore, under the plain language of the Rule, the dismissal operated as an adjudication upon the merits of the alleged corporate cause of action.

This Court has expressly recognized that such adjudications operate with prejudice. In *United States* v. *Procter*

& Gamble Co., 356 U.S. 677, 680 (1958), this Court held that orders dismissing a civil suit because of the government's failure to produce a grand jury transcript were "final orders, ending the case" and cited Rule 41(b) in support of this proposition. In *Costello* v. *United States*, 365 U.S. 265 (1961), this Court discussed the *res judicata* effect of dismissals for failure to obey a court order or the discovery rules as follows:

> "... All of the dismissals enumerated in Rule 41(b) which operate as adjudications on the merits—failure of the plaintiff to prosecute, or to comply with the Rules of Civil Procedure, or to comply with an order of the Court, or to present evidence showing a right to relief on the facts and the law—primarily involve situations in which the defendant must incur the inconvenience of preparing to meet the merits because there is no initial bar to the Court's reaching them. It is therefore logical that a dismissal on one of these grounds should, unless the Court otherwise specifies, bar a subsequent action. . . ." (365 U.S. 286-87)

The rationale for Rule 41(b) contained in the above quotation—that involuntary dismissal orders have *res judicata* effect where entered after the defendant has had to incur the inconvenience of preparing to defend the merits—is fully applicable here. Petitioners' legal fees in *White* exceeded $137,000 and paid for what Judge Wyatt referred to as an "impressive" amount of preparation (A11).

Rule 41(b) expressly provides that dismissals for lack of jurisdiction and certain other dismissals usually entered before extensive preparation on the merits is undertaken by defendants do not have *res judicata* effect. The prior dismissal in *Costello, supra*, which was held not to have *res judicata* effect, had to do with the failure to comply with a jurisdictional precondition for bringing the suit and did not involve a failure to respond to discovery or otherwise go to

the merits.* The *White* dismissal, which is expressly covered by the first sentence of Rule 41(b), does not come within this or any other exception to Rule 41(b).

Consequently, the decision below is flatly inconsistent with Rule 41(b). The Court of Appeals recognized this inconsistency by admitting that:

> "A strict application of Rule 41(b) would seem to require a holding that the dismissal of the *White* action operated as an adjudication upon the merits and hence as a bar to the present derivative suit." (A17)

The technique adopted by the court below for dealing with this inconsistency was to amend Rule 41(b) by taking upon itself the task of carving out an exception to it. As the court said:

> "Accordingly, our decision in this case carves out an exception to the general principles of Rule 41(b) for derivative suits dismissed for failure to answer interrogatories." (A21)

This amendment of Rule 41(b) is beyond the power of a court of appeals. Only this Court may amend the Rules and such amendments must be reported to Congress, 28 U.S.C. § 2072.

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* A dismissal of a derivative suit for failure to post security for costs was similarly treated by three members of the Court of Appeals for the Second Circuit who did not decide the present case. *Saylor* v. *Lindsley*, 391 F.2d 965 (2d Cir. 1968). The dismissal occurred because the shareholder failed to meet a jurisdictional precondition for bringing the suit and had nothing to do with the merits. There the court emphasized that defendants had not been put to the inconvenience of preparing a defense on the merits in the prior case and carefully avoided disturbing the generally understood proposition that an involuntary, pretrial dismissal of a derivative suit on an issue relating to the merits would have *res judicata* effect.

The principal justification asserted by the Court of Appeals for its amendment was the notice provision of Rule 23.1, Fed. R. Civ. P.:

> "The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs." (A2)

This is identical to the notice provision of Rule 23(e) applicable to class actions (A1).

In reaching this result the court below disregarded an important aspect of the relationship between Rule 41 and Rules 23(e) and 23.1. Since the Federal Rules of Civil Procedure were first adopted, Rule 41(a)(1) relating to settlements and voluntary dismissals before answer, has been expressly made subject to the court approval and notice provisions applicable in class actions and derivative suits.* This has not been true of Rule 41(b), which applies to involuntary dismissals. This shows a clear intent that Rule 41(b) dismissals should not be subject to the notice provisions of Rules 23(e) or 23.1.

The reason for not requiring notice of involuntary dismissals is inherent in the reason for the notice requirement in voluntary dismissals and settlements. Its purpose is to discourage collusive settlements which would reward only the plaintiff or his attorney. *Wolf* v. *Barkes*, 348 F.2d 994, 996 (2d Cir.), *cert. denied*, 382 U.S. 941 (1965); *Pelelas*

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*Prior to 1966 Rule 41(a)(1) was expressly subject to former Rule 23(c) applicable both to derivative suits and to other class actions. No change in the text of Rule 41(a)(1) was made in 1966 to reflect the amendments to Rule 23 and the creation of Rule 23.1. In 1968, the reference to Rule 23(c) was changed to Rule 23(e), 5 Moore's Federal Practice ¶ 41.01 [15, 16] at 1014. The failure to make specific reference to Rule 23.1 was inadvertent and Rule 41(a)(1) should be read as if it were subject to both Rules 23(e) and 23.1, 5 Moore's Federal Practice ¶ 41.03 at 1042.

v. *Caterpillar Tractor Co.*, 113 F.2d 629, 633 (7th Cir.), *cert. denied*, 311 U.S. 700 (1940); and, *Marcus* v. *Textile Banking Company*, 38 F.R.D. 185, 187 (S.D.N.Y. 1965). Such collusion would be particularly likely if a settlement or voluntary dismissal could be entered without notice or court approval.

On the other hand, where the case goes to a contested adjudication, the danger of collusion is regarded as much more remote and notice of the proposed adjudication is not considered necessary. In such cases the absent shareholders are bound by the result of the suit. This is just as true where the involuntary adjudication occurs before trial as at trial. It would be difficult for a collusive effort to be concealed at either time because the plaintiff would have to walk a difficult, if not impossible tightrope—he would have to appear to oppose the dismissal as vigorously as he could and yet not oppose it effectively enough to succeed in defeating it. In either event the court can observe whether the opposition is real or feigned and therefore whether the dismissal is in fact voluntary or involuntary.

Heretofore the lower courts have had no difficulty in applying the voluntary-involuntary test in either derivative suits or other class actions. After an involuntary adjudication against the plaintiff shareholder before or at trial, the other shareholders are bound even though no notice has been given of the proposed adjudication.* On the other hand, where the plaintiff has settled or consented to an adverse judgment, notice is required before absent shareholders can be bound.**

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* *Daugherty* v. *Ball*, 43 F.R.D. 329, 335 (C.D. Cal. 1967), *Ratner* v. *Paramount Pictures, Inc.*, 6 F.R.D. 618, 619 (S.D.N.Y. 1942), *Massaro* v. *Fisk Rubber Corp.*, 36 F. Supp. 382, 386 (D. Mass. 1941). See also, 7A Wright & Miller, Federal Practice and Procedure 436 (1972).

** *Pittston Company* v. *Reeves*, 263 F.2d 328, 329 (7th Cir. 1959). *Certain-Teed Products Corporation* v. *Topping*, 171 F.2d 241 (2d Cir. 1948).

The same standards apply in other class actions. Once the Rule 23(c)(2) notice of pendency has gone out and the class has been established, the remaining class members are bound by an adjudication against the class where it was opposed by the class representatives.† On the other hand, where the class representatives settle or consent to an adverse adjudication, a notice of the settlement is required before absent class members are bound.††

The application of these rules to the instant case is also clear. It is undisputed that no fraud or collusion was involved in the *White* dismissal (A27). Three unsuccessful efforts were made to supply properly detailed answers to petitioners' interrogatories (A15). These efforts showed that White lacked any evidentiary basis for her claims. She nonetheless vigorously opposed petitioners' motion to dismiss (A15). Under previously well settled principles, the court below should have held that the *White* dismissal was involuntary and that notice was not required.

The Court of Appeals, however, scrapped the well understood voluntary-involuntary test and invented a new one—whether "on balance" the dismissal was "more analogous" to a voluntary dismissal or to a dismissal following a hearing on the merits (A26). The new test is particularly unfortunate because it is vague and virtually incomprehensible. Is it a question of law, a question of fact or something else?

The old voluntary-involuntary test was relatively easy for judges to apply because it turned on a clearly defined

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† *Dolgow* v. *Anderson*, 53 F.R.D. 664, 690 (E.D.N.Y. 1971), *aff'd*,—F.2d—(2d Cir. 1972), slip op. 3615 (June 20, 1972). *See also, Hutchinson* v. *Fidelity Inv. Ass'n.*, 106 F.2d 431, 436 (4th Cir. 1939). *Pelelas* v. *Caterpillar Tractor Company*, 113 F.2d 629, 633 (7th Cir.), *cert. denied*, 311 U.S. 700 (1940).

†† *Cunningham* v. *English*, 269 F.2d 539 (D.C. Cir.), *cert. denied*, 361 U.S. 897 (1959), *reh. denied*, 361 U.S. 950 (1960). *Research Corporation* v. *Asgrow Seed Company*, 425 F.2d 1059, 1060 (7th Cir. 1970).

and highly relevant question of fact. The new "more analogous" test, on the other hand, will in many cases make it difficult if not impossible for judges to determine whether notice is necessary and is bound to produce only confusion and wasted judicial effort.

The asserted justification for adopting the new test is the possibility that in some future case a plaintiff will deliberately fail to respond to discovery for the sole purpose of losing the case and that the door will thereby be open to collusive dispositions of such cases (A24, A25). If such nefarious schemes are likely to escape the court's notice before trial, they are just as likely to succeed at trial when plaintiff can refrain from introducing damaging evidence.

The new "more analogous" test, which according to the court below would only apply to pretrial dismissals, is not a logical way of dealing with such possibilities. The voluntary-involuntary standard, on the other hand, covered the asserted problem in the proper way. By definition a deliberate failure to act at any time in the proceedings which is intended to produce a dismissal would in fact produce a voluntary dismissal not binding on absent class members.

An additional purpose of requiring notice of a pretrial involuntary dismissal going to the merits was said to be to protect the absent class members from the loss that could result if their representative becomes fainthearted or lazy. Again, if such protection is needed before trial, it is needed just as much at trial. And again, at either stage the court can observe whether the opposition is vigorous or merely half-hearted.

The argument that absent class members need this special protection against feigned or half-hearted representation before trial is based upon the specious assumption that trial judges can easily be duped. There is no reason to believe that feigned or half-hearted opposition to a pre-

trial motion to dismiss is any more likely to escape the court's scrutiny in class litigation, where the court is particularly on the lookout for it, than in any other kind of litigation.

In the court below respondent suggested that she was not bound by the *White* decision on the ground that White was an inadequate representative of the shareholders. This claim is really a suggestion that respondent could have done a better job of answering petitioners' interrogatories or in opposing petitioners' motion to dismiss than White did. This contention got nowhere because respondent, who has the burden of proof in her collateral attack on *White, Esenwein* v. *Commonwealth ex. rel. Esenwein*, 325 U. S. 279 (1945), made no showing that she could have supplied better answers or more effectively opposed petitioners' dismissal motion. It was perhaps in recognition of this that the court below, though it expressed uncertainty concerning whether White was an adequate representative, expressly declined to decide this question (A28, A29). Respondent also apparently recognized her inability to establish inadequacy when she failed to move to reopen the *White* judgment under Rule 60(b), Fed. R. Civ. P., her proper remedy if she had any evidentiary basis for her inadequacy claim.*

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* In support of her inadequacy claim, respondent referred to White's delay in answering and to a remark made by the magistrate in *White* that White was not "serious in prosecuting". However, White's tardiness was in part due to her desire to await the first trial involving the basic theories set forth in her complaint and the appeal therefrom in *Moses* v. *Burgin*, 316 F. Supp. 31 (D. Mass. 1970), *aff'd in part and rev'd in part*, 445 F.2d 369 (1st Cir.), *cert. denied sub nom. Johnson* v. *Moses*, 404 U.S. 994 (1971) (A16), and was also due to her confessed inability to supply more detailed answers. The magistrate's remark, which was merely a reflection of this and which did not refer to whether White was serious in attempting to keep the case alive or in her desire to prosecute after the *Moses* decision, did not purport to deal with her adequacy as a representative. Nor was any finding of inadequacy ever made in that case or in the present case.

Few propositions are more unanimously accepted than the conclusion that trial judges must take firm control of discovery in class litigation as a sheer matter of survival.* The *White* dismissal was based upon a discovery order and was one of the sanctions permitted under Rule 37, Fed. R. Civ. P. It is important that the powers of trial courts under this rule not be undermined in derivative or other class litigation. The decision below has eroded this power because it provides that even though discovery proceedings reveal that plaintiff has no case, the court may not dismiss with prejudice without stopping everything and putting out notice. For this additional reason this Court should review the decision below.

The present case is peculiarly appropriate for dealing with the notice issue. That issue is sharply presented in a record of considerably more manageable proportions than will be presented in many derivative or other class actions. The appendix on appeal below was only 95 pages long and the record in *White*, though more lengthy, is also easily manageable. Moreover, *res judicata* questions are most appropriately dealt with in the second case where the *res judicata* question arises (as in the present case) rather than in the first case where the *res judicata* effect can only be predicted. This case is also particularly appropriate for review of the notice issue because the record does not confuse that issue with numerous other issues.

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* Manual for Complex and Multidistrict Litigation, Part I §§ 0.22 and 1.1 (1972).

Conclusion

Heretofore, the voluntary-involuntary standard was well established under Rule 41(b) and principles set forth in decisions of this Court and other courts. Pursuant to this standard it was reasonably clear when notice was necessary in a class action to bind absent class members. The erroneous decision of the court below has improperly amended Rule 41(b) and introduced a vague new "more analogous" standard which has created great confusion as to when notice is necessary—a very important aspect of class action procedure. If the decision is not corrected by this Court it is likely to cause a substantial waste of judicial effort and may tend to hamper judges in controlling discovery in class litigation. This Court should correct the decision below and eliminate these problems.

For the foregoing reasons the writ should be granted.

Dated: October 18, 1972

Respectfully submitted,

JUDSON A. PARSONS, JR.
Attorney for Petitioners
140 Broadway
New York, New York 10005
Phone: (212) 344-8000

KEITH E. MCCLINTOCK
PATRICIA N. COLLOTON
DEWEY, BALLANTINE, BUSHBY,
PALMER & WOOD
Of Counsel.

APPENDIX

Statute and Rules Involved

Rules of civil procedure, 28 U.S.C. § 2072 (1970), 62 Stat. 961 as amended:

§ 2072. Rules of civil procedure

The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil actions, including admiralty and maritime cases, and appeals therein, and the practice and procedure in proceedings for the review by the courts of appeals of decisions of the Tax Court of the United States and for the judicial review or enforcement of orders of administrative agencies, boards, commissions, and officers.

Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution.

Such rules shall not take effect until they have been reported to Congress by the Chief Justice at or after the beginning of a regular session thereof but not later than the first day of May, and until the expiration of ninety days after they have been thus reported.

All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect. Nothing in this title, anything therein to the contrary notwithstanding, shall in any way limit, supersede, or repeal any such rules heretofore prescribed by the Supreme Court.

Fed. R. Civ. P., Rule 23(e), 28 U.S.C. (1970):

Rule 23.—CLASS ACTIONS

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise

shall be given to all members of the class in such manner as the court directs.

Fed. R. Civ. P., Rule 23.1, 28 U.S.C. (1970):

Rule 23.1.—DERIVATIVE ACTIONS BY SHAREHOLDERS

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

Fed. R. Civ. P., Rule 41(a) and (b), 28 U.S.C. (1970):

Rule 41.—DISMISSAL OF ACTIONS

(a) Voluntary Dismissal: effect thereof.

(1) *By Plaintiff; by Stipulation.* Subject to the provisions of Rule 23(e), of Rule 66, and of any statute of the

United States, an action may be dismissed by the plaintiff without order of court (i) by filing a notice of dismissal at any time before service by the adverse party of an answer or of a motion for summary judgment, whichever first occurs, or (ii) by filing a stipulation of dismissal signed by all parties who have appeared in the action. Unless otherwise stated in the notice of dismissal or stipulation, the dismissal is without prejudice, except that a notice of dismissal operates as an adjudication upon the merits when filed by a plaintiff who has once dismissed in any court of the United States or of any state an action based on or including the same claim.

(2) *By Order of Court.* Except as provided in paragraph (1) of this subdivision of this rule, an action shall not be dismissed at the plaintiff's instance save upon order of the court and upon such terms and conditions as the court deems proper. If a counterclaim has been pleaded by a defendant prior to the service upon him of the plaintiff's motion to dismiss, the action shall not be dismissed against the defendant's objection unless the counterclaim can remain pending for independent adjudication by the court. Unless otherwise specified in the order, a dismissal under this paragraph is without prejudice.

(b) **Involuntary Dismissal: effect thereof.** For failure of the plaintiff to prosecute or to comply with these rules or any order of court, a defendant may move for dismissal of an action or of any claim against him. After the plaintiff, in an action tried by the court without a jury, has completed the presentation of his evidence, the defendant, without waiving his right to offer evidence in the event the motion is not granted, may move for a dismissal on the ground that upon the facts and the law the plaintiff has shown no right to relief. The court as trier of the facts may then determine them and render judgment against the plaintiff or may decline to render any judgment until the

close of all the evidence. If the court renders judgment on the merits against the plaintiff, the court shall make findings as provided in Rule 52(a). Unless the court in its order for dismissal otherwise specifies, a dismissal under this subdivision and any dismissal not provided for in this rule, other than a dismissal for lack of jurisdiction, for improper venue, or for failure to join a party under Rule 19, operates as an adjudication upon the merits.

Former Fed. R. Civ. P., Rule 23(c), 28 U.S.C. (1938):

Rule 23.—CLASS ACTIONS

(c) **Dismissal or Compromise.** A class action shall not be dismissed or compromised without the approval of the court. If the right sought to be enforced is one defined in paragraph (1) of subdivision (a) of this rule notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs. If the right is one defined in paragraphs (2) or (3) of subdivision (a) notice shall be given only if the court requires it.

Opinion of the District Court

PAPILSKY v. BERNDT, ET AL.,
71 Civ. 2534
UNITED STATES DISTRICT COURT,
SOUTHERN DISTRICT NEW YORK
November 17, 1971

WYATT, District Judge.

This is a motion by three of the named defendants—Lord, Abbett & Co., Alvin H. Berndt and Robert S. Driscoll—for summary judgment in their favor. Fed.R.Civ.P. 56(c).

The action was commenced on June 7, 1971. Plaintiff brings the action as the owner of stock of defendant Affiliated Fund, Inc. (Fund), a Delaware corporation, and the action is a derivative one to enforce a right of Fund. Fed.R. Civ.P. 23.1.

Fund is an open-end diversified investment company, said to be registered under the Investment Company Act of 1940 (15 U.S.C. § 80a-1 and following). Lord, Abbett & Co. (Lord) is a partnership. Berndt and Driscoll are partners of Lord and are officers and directors of Fund. Lord is employed by Fund as investment manager of Fund under an agreement.

The claim asserted in the case at bar is that Lord, in connection with transactions for Fund, uses "reciprocal brokerage, give-ups and interpositioning" and has received additional compensation by so doing. It is moreover charged that Lord, by its use of such techniques, has paid dealers which sell shares of Fund to the public and that Lord has been thus relieved of the necessity to compensate such dealers.

Fund, it is claimed, has been damaged because the use of reciprocal brokerage, give-ups and interpositioning has

resulted in excessive compensation to Lord. Demand is made that Lord and the individual defendants pay $6,000,000 in damages to Fund.

On January 10, 1967, Vera G. White commenced an action in this Court (67 Civ. 98) against all the defendants in the case at bar and other defendants not named in the case at bar.

On March 28, 1968, Anne Bernstein commenced an action in this Court (68 Civ. 1252) against all the defendants in the case at bar and other defendants not named in the case at bar.

By order filed August 30, 1968, the White and Bernstein actions were consolidated. Plaintiffs thereafter served a "consolidated complaint" which was filed on September 26, 1968. The consolidated action will be referred to as the "White action".

Fund was a defendant in the White action but was the nominal defendant for whose benefit the action was brought. Fund was represented by separate counsel who represented only Fund in the White action.

It is undisputed that the claims in the White action are the same as those now asserted in the case at bar.

By order in the White action filed on January 14, 1969, plaintiffs were directed to answer certain interrogatories served by defendants. Plaintiffs White and Bernstein did not answer the interrogatories.

In the White action and on February 3, 1971, defendants Lord, Driscoll and Trevor obtained an order that "the *plaintiffs* show cause" (emphasis supplied) why the action should not be dismissed for failure to answer the interrogatories. The order to show cause was returnable on February 11, 1971, and it is assumed that a copy of the order was served on counsel for Fund.

In the White action, defendants Johnston, Knobloch, and James H. Potter by notice of motion brought on a motion to dismiss the action for the same reason, failure of plaintiffs to answer the interrogatories. The notice of motion was addressed, among others, to counsel for Fund.

The two motions—one made by order and one by notice—were heard by me on February 11, 1971. Fund took no position on these motions and submitted no papers.

The two motions were referred to Honorable Gregory J. Potter as Special Master. The report of the Special Master was dated March 4, 1971, and advised that the White action be dismissed for failure to answer the interrogatories. The Special Master concluded that plaintiffs "are not serious in prosecuting this action".

The motions were then granted by me and the Clerk was directed to enter judgment dismissing the White action as to the moving defendants. Judgment, filed on March 22, 1971, was that the moving defendants "have judgment against plaintiff Anne Bernstein dismissing the complaint as to the said defendants only". By order filed March 31, 1971, the decretal paragraph of the judgment was amended "to include plaintiff Vera G. White".

It appears that outside of the moving defendants, the only defendant served in the White action was Fund, the nominal defendant for whose benefit the action was brought.

The White action remained pending against Fund, the nominal defendant, and no other defendants were served after the judgment of dismissal as to the moving defendants.

The White action was called by the Chief Judge on the Review Calendar on December 8, 1970 and plaintiffs were given until May 14, 1971 to file a note of issue for trial, etc. By order filed June 14, 1971, the Chief Judge dismissed the

action "for lack of prosecution, without prejudice and without costs".

The question on the present motion in the case at bar is whether the judgment in the White action was an "adjudication on the merits" (Fed.R.Civ.P. 41(b)) so as to bar the present claim. This question is not without difficulty. No decision on the precise point has been cited by counsel and none has been turned up by independent research.

The conclusion I reach is that dismissal of the White action was not an "adjudication on the merits" of the claim of Fund and that the present motion must be denied. On the other hand, granting the motion would end the litigation. The situation thus seems appropriate for review by the Court of Appeals under 28 U.S.C. § 1292(b).

Preliminarily it should be noted that in the White action there was no "notice of the proposed dismissal" to shareholders. Fed.R.Civ.P. 23.1. Probably this was because counsel then concerned believed that the cited Rule was not applicable; possibly it was due to inadvertence.

By its wording, Rule 23.1 requires notice of *any* dismissal. There are no exceptions.

Able counsel for movants argue that notice is required only for "voluntary" dismissals. There is language in at least one case which gives some support to this view. Some support is found in Hutchinson v. Fidelity Inv. Ass'n, 106 F.2d 431, 436 (4th Cir. 1939) but in that case the action was dismissed "after hearing on the merits" (106 F.2d at 436). A law review author has flatly stated that the notice requirement "applies only to voluntary, not to involuntary dismissals". Simeone, Procedural Problems of Class Suits, 60 Mich.L.Rev. 905, 934 (1962) Judge Tenney has held that notice is not required where dismissal is for lack of juris-

diction over the person. Marcus v. Textile Banking Corp., 38 F.R.D. 185 (S.D.N.Y.1965) In Daugherty v. Ball, 43 F.R.D. 329, 334-336 (C.D.Cal.1967) the question is discussed in respect of dismissals on the merits.

There are good reasons for not requiring notice when dismissal is on the merits. In such a case, there is a judicial determination that the real defendants are not liable. When, however, the dismissal is for some reason personal to plaintiff and there is no judicial exoneration of the real defendants, there is less reason for dispensing with notice. An example of such a situation is seen in Saylor v. Lindsley, 391 F.2d 965 (2d Cir. 1968) where plaintiff in an earlier action failed to post a required bond and there was dismissal of that action; it was not discussed whether notice should have been given.

I am inclined to believe that notice to shareholders was required in connection with dismissal of the White action. For purposes of the present motion, however, it will be assumed that no notice was required.

[1] Analysis of the nature of a derivative suit by a stockholder shows that dismissal of the White action does not bar the present action.

[2] The derivative suit contains two claims: (1) a claim *by* the corporation in which plaintiff is a stockholder, and (2) a claim by the stockholder against his corporation for its failure to enforce the claim belonging to it ((1) above). Ballantine, Private Corporations, 612

This analysis was made by the Supreme Court last year in Ross *v.* Bernhard, 396 U.S. 531, 90 S.Ct. 733, 24 L.Ed.2d 729, which dealt with the right to a jury trial in derivative actions. The Supreme Court said (396 U.S. at 534-535, 90 S.Ct. at 736):

> "As elaborated in the cases, one precondition for the suit was a valid claim on which the corporation could

> have sued; another was that the corporation itself had refused to proceed after suitable demand, unless excused by extraordinary conditions. Thus the dual nature of the stockholder's action: first, the plaintiff's right to sue on behalf of the corporation and, second, the merits of the corporation claim itself."

and again (396 U.S. at 538, 90 S.Ct. at 736):

> "We have noted that the derivative suit has dual aspects: first, the stockholder's right to sue on behalf of the corporation, historically an equitable matter; second, the claim of the corporation against directors or third parties on which, if the corporation had sued and the claim presented legal issues, the company could demand a jury trial."

The policy and purpose of Rule 41(b) is accomplished by giving effect to the dismissal of the White action as an "adjudication upon the merits" of the claim of the White plaintiffs against Fund, that is to say, their claim to sue on behalf of Fund. There is a reluctance, however, to treat that dismissal as adjudicating the second aspect of the claim in the White action, that is, the claim of Fund against the other defendants. That claim has never been heard on its merits (and of course no opinion is here implied that it has, or has not, any merit). Fund took no part in the motions to dismiss in the White action. That action was not dismissed as to Fund until Chief Judge Sugarman entered his order of dismissal and that order was "without prejudice".

A further policy consideration may be noted. There is not the slightest suggestion of any impropriety in the motions to dismiss and in the dismissal of the White action; the Court at the time was fully advised in the premises. Nevertheless, a rule which would permit such a dismissal to

bar the claim of the corporation beneficiary would in some future time afford opportunities for collusion in procuring the dismissal of derivative actions. For a thoughtful discussion of a somewhat similar problem involving class actions, see Judge Decker's opinion in Yaffe v. Detroit Steel Corp., 50 F.R.D. 481 (N.D.Ill. 1970).

Careful attention has been paid to Costello v. United States, 365 U.S. 265, 81 S.Ct. 534, 5 L.Ed.2d 551 (1961). The Supreme Court there discussed Rule 41(b) and emphasized that dismissals which are "adjudications upon the merits" under that Rule are primarily those involving "situations in which the defendant must incur the inconvenience of preparing to meet the merits because there is no initial bar to the Court's reaching them" (365 U.S. at 286, 81 S.Ct. at 545). I am prepared to assume that such was the situation in the White action; the movants show an impressive amount of preparation by them in that action. The decision on the present motion is not that Rule 41(b) does not apply. On the contrary, Rule 41(b) does apply and its application bars the claim which belonged to the White plaintiffs. Rule 41(b), however, does not require that the claim be barred which belonged to Fund.

For the reasons indicated, the motion is denied.

I am of the opinion that this order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation. 28 U.S.C. § 1292(b).

So ordered.

Dated: November 17, 1971

INZER B. WYATT
United States District Judge

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 759—September Term, 1971.

(Argued May 24, 1972 Decided August 1, 1972.)

Docket No. 72-1052

PAULETTE PAPILSKY,

Plaintiff-Appellee,

v.

ALVIN H. BERNDT, ROBERT S. DRISCOLL and LORD, ABBETT & Co.,

Defendants-Appellants,

and

CARL W. KNOBLOCH, GLEN A. LLOYD, JAMES H. POTTER, PAUL W. H. TREVOR, PAUL WINDSOR, JR. and AFFILIATED FUND, INC.,

Defendants.

Before:

LEVENTHAL,* FEINBERG and TIMBERS,

Circuit Judges.

Appeal pursuant to 28 U.S.C. § 1292(b) (1970) from an order of the District Court for the Southern District of New York, Inner B. Wyatt, *District Judge*, 333 F.Supp.

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*Of the United States Court of Appeals for the District of Columbia Circuit, sitting by designation.

1084, denying defendants' motion for summary judgment based on *res judicata*.

Affirmed.

ABRAHAM L. POMERANTZ, New York, N. Y. (Mordecai Rosenfeld, William E. Haudek, Daniel W. Krasner and Pomerantz, Levy, Haudek & Block, New York, N. Y., on the brief), *for plaintiff-appellee*.

JUDSON A. PARSONS, JR., New York, N. Y. (Hugh N. Fryer, Keith E. McClintock, Jr., Patricia A. Nelson and Dewey, Ballantine, Bushby, Palmer & Wood, New York, N. Y., on the brief), *for defendants-appellants*.

TIMBERS, *Circuit Judge:*

The essential issue on this appeal is whether dismissal of a stockholder's derivative suit, without notice to non-party stockholders, under Fed. R. Civ. P. 37(b)(2)(C), for failure to answer interrogatories, operates as a bar to an identical cause of action asserted by another stockholder in a subsequent derivative suit.

Plaintiff Paulette Papilsky is a shareholder of defendant Affiliated Fund, Inc. and brought this action derivatively on behalf of Affiliated, a diversified open-end investment company registered under the Investment Company Act of 1940. Defendant Lord, Abbett & Co. serves as Affiliated's investment adviser and as its principal underwriter. Defendants Driscoll and Berndt are partners in Lord, Abbett and officers and directors of Affiliated. Papilsky's complaint alleged that these defendants failed

to recapture, and to credit Affiliated with, allegedly recapturable portions of brokerage commissions paid on portfolio transactions and asserted that this has resulted in the payment of higher management fees to Lord, Abbett, all in violation of the federal securities laws.[1] Shortly after the complaint was served, defendants Driscoll, Berndt and Lord, Abbett served and filed a motion seeking summary judgment on the ground of *res judicata*. They alleged that the claims asserted by Papilsky were identical to those asserted in a previous derivative suit against Driscoll, Berndt, Lord, Abbett and other defendants entitled *White and Bernstein* v. *Driscoll, et al.*, S.D.N.Y. 67 Civ. 98 (the "*White* action"), which had been dismissed for failure to answer interrogatories. Judge Wyatt on November 17, 1971 denied defendants' motion for summary judgment, 333 F. Supp. 1084, but granted the necessary certification to appeal pursuant to 28 U.S.C. § 1292(b) (1970), as did we on December 6, 1971. For the reasons stated below, we affirm the denial of the motion for summary judgment.

I.

The *White* action was a consolidation of two separate stockholders' derivative actions, the first commenced in January of 1967 and the second in February of 1968. As the district court found, "[i]t is undisputed that the claims in the *White* action are the same as those now asserted in the case at bar." 333 F. Supp. at 1085. There is no suggestion, however, that the *White* plaintiffs or their attorneys are in any way connected with the instant case.

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[1] §§1(b)(2), 2(a)(3), 2(a)(9), 10, 15, 17(e), (h) and (i), 36 and 37 of the Investment Company Act of 1940, 15 U.S.C. §§80a-1(b)(2), 80a-2(a)(3), 80a-2(a)(9), 80a-10, 80a-15, 80a-17(e), (h) and (i), 80a-36 and 80a-37 (1970); §§10(b) and 15(c)(1) and (2) of the Securities Exchange Act of 1934, 15 U.S.C. §§78j and 78o(c)(1) and (2) (1970); and §206(4) of the Investment Advisers Act of 1940, 15 U.S.C. §80b-6(4) (1970).

On January 14, 1969, the district court entered orders directing the *White* plaintiffs to answer interrogatories on February 15, 1969, which date was extended to March 4, 1969. The interrogatories ordered to be answered requested the *White* plaintiffs to specify the claimed violations of law and sought details as to each claimed violation. On March 31, 1970, more than a year after the deadline for answering the interrogatories, the *White* plaintiffs filed their answers. The defendants considered these unsigned and unverified answers to be unacceptable and returned them to plaintiffs. Thereafter, on December 10, 1970, the *White* plaintiffs served by mail purported answers to the interrogatories. The defendants also found these responses to be inadequate.

On February 3, 1971, the *White* defendants brought on by order to show cause a motion pursuant to Fed. R. Civ. P. 37(b)(2)(C) seeking dismissal of the action on the ground of the plaintiffs' failure to answer the interrogatories as required by the district court's order of January 14, 1969.[2] The *White* plaintiffs opposed the granting of this motion.

Judge Wyatt referred the motion to a Special Master. The Master concluded that plaintiffs' long delayed answers to the interrogatories were "totally inadequate" and that

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[2] Fed. R. Civ. P. 37(b)(2)(C) provides as follows:

"If a party or an officer, director, or managing agent of a party or a person designated under Rule 30(b)(6) or 31(a) to testify on behalf of a party fails to obey an order to provide or permit discovery, including an order made under subdivision (a) of this rule or Rule 35, the court in which the action is pending may make such orders in regard to the failure as are just, and among others the following:

* * *

(C) An order striking out pleadings or parts thereof, or staying further proceedings until the order is obeyed, or dismissing the action or proceeding or any part thereof, or rendering a judgment by default against the disobedient party."

"[t]he deficiency of the answers to interrogatories and the delay in serving them demonstrates that plaintiffs are not serious in prosecuting this action." Accordingly, the Master recommended that the *White* action be dismissed.

In March 16, 1971, Judge Wyatt entered an order granting defendants' motion and dismissing the action as to all defendants served other than the nominal defendant, Affiliated. Notice of the dismissal was not given to nonparty stockholders. On March 22, 1971, a judgment was entered dismissing the action as to the moving defendants, which judgment was amended by endorsement on March 30, 1971 to include both plaintiffs. Neither the judgment nor the orders provided that the dismissal was without prejudice.

As a result of the judgment, there continued pending on the district court's docket a derivative action in which Affiliated, the nominal defendant, was the only remaining defendant which had been served. On June 12, 1971, Chief Judge Sugarman entered a routine calendar order of dismissal, stated to be without prejudice.

Plaintiff Papilsky filed her complaint in the instant action on June 7, 1971.[3]

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[3] On June 4, 1971, three days before Papilsky filed her complaint, the First Circuit held that claims similar to those asserted in Papilsky's complaint did constitute violations of the Investment Company Act of 1940. *Moses* v. *Burgin*, 445 F.2d 369 (1 Cir.), *cert. denied sub nom. Johnson* v. *Moses*, 404 U.S. 994 (1971). The First Circuit thereby reversed in part a district court judgment of August 18, 1970 which had dismissed on the merits a derivative suit brought on behalf of a mutual fund involving claims similar to those asserted in *White*. *Moses* v. *Burgin*, 316 F.Supp. 31 (D. Mass. 1970). In opposing the *White* defendants' motion for dismissal pursuant to Rule 37(b)(2)(C), the *White* plaintiffs tried to excuse their delay in answering the interrogatories by arguing that it was reasonable for them to wait for the First Circuit's decision in *Moses* before framing their answers to the interrogatories.

II.

It is now well established that Fed. R. Civ. P. 41(b) states the effect to be accorded a dismissal under Fed. R. Civ. P. 37.[4] *Stebbins* v. *State Farm Mutual Automobile Insurance Co.*, 413 F.2d 1100, 1102 (D.C. Cir.), *cert. denied*, 396 U.S. 895 (1969); *Nasser* v. *Isthmian Lines*, 331 F.2d 124, 127 (2 Cir. 1964). Rule 41(b) provides in relevant part that:

> "Unless the court in its order for dismissal otherwise specifies, a dismissal under this subdivision and any dismissal not provided for in this rule, other than a dismissal for lack of jurisdiction, for improper venue, or for failure to join a party under Rule 19, operates as an adjudication upon the merits."

The order and judgment dismissing the *White* action were not stated to be without prejudice. A strict application of Rule 41(b) would seem to require a holding that the dismissal of the *White* action operated as an adjudication upon the merits and hence as a bar to the present derivative suit. Indeed, the Supreme Court has made it more than clear in dicta that dismissals coming within the literal terms of Rule 41(b) generally do have *res judicata* effect. *Costello* v. *United States*, 365 U.S. 265, 286 (1961). Moreover, we have held that a dismissal pursuant to Rule 37 for failure to answer interrogatories is an adjudication upon the merits and bars an identical cause of action asserted in a subsequent suit. *Nasser* v. *Isthmian Lines, supra*, 331 F.2d at 128. *Nasser*, however, was neither a class action nor a stockholder's derivative action. Rather, *Nasser* involved

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[4] There is nothing to the contrary in *Societe Internationale Pour Participations Industrielles et Commerciales, S.A.* v. *Rogers*, 357 U.S. 197, 207 (1958). There the Court merely indicated that the standards for granting or denying a motion to dismiss for failure to comply with discovery orders are governed by Rule 37, not Rule 41(b). That opinion did not suggest, however, that the effect of a Rule 37 dismissal was not to be determined by Rule 41.

a plaintiff asserting a cause of action which belonged solely to him as an individual. Papilsky strongly urges that a different result is required where the plaintiff is a stockholder suing on behalf of a corporation.

The district court agreed with Papilsky and refused to accord *res judicata* effect to the *White* action. The court stated:

> "The derivative suit contains two claims: (1) a claim by the corporation in which plaintiff is a stockholder and (2) a claim by the stockholder against his corporation for its failure to enforce the claim belonging to it ((1) above)." 333 F.Supp. at 1087.

While conceding that Rule 41(b) applies to dismissals under Rule 37, the court concluded that the dismissal of the *White* action barred only the claim of the *White* plaintiffs against Affiliated, and not Affiliated's cause of action against the defendants.

III.

While we agree with the district court's holding that the judgment in the *White* action is not binding on nonparty stockholders, we do so without accepting the court's analysis of the nature of a stockholder's derivative action.

A stockholder's derivative action is a suit to enforce a corporate cause of action against officers, directors or third parties. Such an action consists of only one claim—the corporate claim against the alleged wrongdoers. The alleged injury inflicted upon the corporation is regarded as affecting only the corporation. The fact that the injury

may indirectly harm a stockholder by diminishing the value of his corporate shares does not bestow upon him a right to sue on his own behalf to recover damages. *Kauffman* v. *Dreyfus Fund, Inc.*, 434 F.2d 727, 732 (3 Cir. 1970), *cert. denied*, 401 U.S. 974 (1971); *Hodge* v. *Meyer*, 252 Fed. 479, 483 (2 Cir.), *cert. denied*, 248 U.S. 565 (1918). See also McLaughlin, *Capacity of Plaintiff-Stockholder to Terminate a Stockholder's Suit*, 46 Yale L.J. 421, 421 n. 2 (1936). Rather, assuming that a stockholder has satisfied the prerequisites of Fed. R. Civ. P. 23.1, he merely has a right to bring a derivative action on behalf of the corporation. As Justice Frankfurter stated in his dissenting opinion in *Smith* v. *Sperling*, 354 U.S. 91, 99 (1957):

> "The contrasting difference between a stockholder's suit for his corporation and a suit by him against it, is crucial. In the former, he has no claim of his own; he merely has a personal controversy with his corporation regarding the business wisdom or legal basis for the latter's assertion of a claim against third parties. Whatever money or property is to be recovered would go to the corporation, not a fraction of it to the stockholder. When such a suit is entertained, the stockholder is in effect allowed to conscript the corporation as a complainant on a claim that the corporation, in the exercise of what it asserts to be its uncoerced discretion, is unwilling to initiate."

Accord, *Kauffman* v. *Dreyfus Fund, Inc.*, *supra*, 434 F.2d at 734-35. This right "to conscript the corporation as a complainant" cannot be equated with a cause of action against the corporation. A corporation cannot be held liable to a plaintiff-stockholder for failing to prosecute an allegedly valid corporate claim. Rather than initiating a cause of action against the corporation, the plaintiff-stock-

holder in a derivative suit is seeking to enforce, for the benefit of the corporation, a corporate claim which the corporation, for whatever reason, is unwilling to prosecute.

The district court's reliance on *Ross* v. *Bernhard*, 396 U.S. 531 (1970), for the proposition that a stockholder's derivative suit consists of two claims, is misplaced. There the Court merely recognized "the dual nature of the stockholder's action: first, the plaintiff's right to sue on behalf of the corporation and, second, the merits of the corporation's claim itself." 396 U.S. at 534-35. There is nothing in the opinion which elevates a stockholder's right to sue on behalf of the corporation to the level of a stockholder's claim against the corporation for failure to enforce a corporate cause of action. To the contrary, the Court's analysis of the nature of a stockholder's derivative suit is entirely consistent with our conclusion that such an action consists of only one claim—the corporate claim:

> "The claim pressed by the stockholder against directors or third parties 'is not his own but the corporation's.' *Koster* v. *Lumbermens Mut. Cas. Co.*, 330 U.S. 518, 522 (1947). The corporation is a necessary party to the action; without it the case cannot proceed. Although named a defendant, it is the real party in interest, the stockholder being at best the nominal plaintiff. The proceeds of the action belong to the corporation and it is bound by the result of the suit. The heart of the action is the corporate claim." 396 U.S. at 538-39.

Accordingly, the district court's dismissal of the *White* action encompassed the corporate claim which a different stockholder is now asserting in the present derivative suit. The question which we must now consider is whether the judgment in the *White* action should be given *res judicata*

effect, even though notice of the proposed dismissal of the *White* action was not given to nonparty stockholders.

IV.

We hold that, when notice of a proposed dismissal of a stockholder's derivative suit for failure to answer interrogatories is not given to nonparty stockholders, the judgment of dismissal does not bar an identical cause of action asserted by a different stockholder in a subsequent derivative suit. As previously indicated, the order and judgment dismissing the *White* action were not stated to be without prejudice and hence the effect of the dismissal normally would be to preclude the initiation of a suit based on the same cause of action. See *Costello* v. *United States, supra,* 365 U.S. at 286; *Nasser* v. *Isthmian Lines, supra,* 331 F.2d at 128. Accordingly, our decision in this case carves out an exception to the general principles of Rule 41(b) for derivative suits dismissed for failure to answer interrogatories.[5] While we have been unable to find a case precisely

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[5] Appellants contend that *Saylor* v. *Lindsley,* 391 F.2d 965 (2 Cir. 1968), indicated that no such exception should be created. That case involved the effect to be given a derivative action dismissed for failure to post a security bond. This Court refused to accord *res judicata* effect to the judgment of dismissal, as the stockholder had merely failed to satisfy a precondition for bringing the suit. 391 F.2d at 969. Cf. *Costello* v. *United States, supra,* 365 U.S. at 286. In dictum, the Court did say:

> "Although neglect to prosecute would normally provide an appropriate occasion for the invocation of Rule 41(b). . . ." 391 F.2d at 969.

This dictum is not necessarily inconsistent with our decision today. We agree that dismissal for failure to prosecute, when not stated to be without prejudice, would normally preclude the bringing of another suit based on the same cause of action. Assuming that a dismissal for failure to prosecute should be treated the same as a dismissal for failure to answer interrogatories, our decision simply carves out an exception to the general rule in the case of a stockholder's derivative suit.

in point,[6] principles enunciated in analogous situations do lend support to our holding. In short, our decision today marks no new departure in the law.

Courts traditionally have exhibited understandable caution in according *res judicata* effect to a prior derivative action in which the present plaintiff-stockholder did not participate. Such caution is warranted in the context of derivative actions in view of the fact that the plaintiff-stockholder is affecting a right which belongs to the corporation. To discourage the plaintiff from sacrificing the corporate cause of action to further his own self interest, notice of proposed dismissals to nonparty stockholders is required in a variety of situations. Where notice is a prerequisite to a dismissal of a derivative action, a judgment of dismissal will not be accorded *res judicata* effect unless such notice was given. *Winkelman* v. *General Motors Corp.*,

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[6] The able District Judge below indicated that he was "inclined to believe that notice to shareholders was required in connection with dismissal of the White action." 333 F. Supp. at 1086-87. However, because of his view of the nature of a stockholder's derivative suit, he assumed for the purposes of his decision that notice was not required.

In an analogous situation, the Eighth Circuit has held that notice of a proposed dismissal of a class action for lack of prosecution was not required "under the circumstances [t]here presented." *Partridge* v. *St. Louis Joint Stock Land Bank*, 130 F. 2d 281, 286 (8 Cir. 1942). The circumstances of that case were unusual, as the suit had been pending for nine years and no other members of the class had sought to intervene. Moreover, the *Partridge* decision said nothing about the effect to be given the dismissal in the event a subsequent suit were brought by a different member of the class. Furthermore, the *Partridge* decision has met with critical comment:

> "This result can be criticized, however, since a failure to prosecute may reflect the fact that the representatives have lost interest in the suit because their own goals have been satisfied or for a number of reasons unrelated to the merits of the action or the rights of the other class members. Should this be the case, the representatives might refuse to pursue the action and not seek the court's approval of a dismissal, thereby intentionally or unintentionally evading the safeguards provided by subdivision (e) [notice and court approval]." 7A Wright & Miller, Federal Practice and Procedure 236 (1972).

39 F.Supp. 826, 831 (S.D.N.Y. 1940). *Cf. Smith* v. *Alleghany Corp.*, 394 F.2d 381, 391 (2 Cir.), *cert. denied*, 393 U.S. 939 (1968); *Stella* v. *Kaiser*, 218 F.2d 64, 65 (2 Cir. 1954), *cert. denied*, 350 U.S. 835 (1955).

In general, notice of a proposed dismissal of a derivative suit must be given to nonparty stockholders when the corporate claim has not been adjudicated upon the merits. Fed. R. Civ. P. 23.1. Rule 23.1 provides in relevant part that a stockholder's derivative action "shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs."[7] The notice requirements of Rule 23.1 have been construed to apply to more than just dismissals of derivative suits following settlements. It is clear, for example, that voluntary dismissals under Fed. R. Civ. P. 41(a)(1) are within the scope of the notice requirements of Rule 23.1.[8] 3B Moore's Federal Practice ¶23.1.24[2] (1969); 7A Wright & Miller, Federal Practice and Procedure 435 (1972). Moreover, in order to prevent simple evasion of the safeguards of the Rule 23.1 notice provisions,

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[7] Prior to 1966, the last sentence of Rule 23.1, which is quoted above, was covered by Rule 23(c). When stockholders' derivative suits were accorded separate treatment by the 1966 amendment, the notice and court approval prerequisites for derivative actions were preserved unchanged in Rule 23.1. Thus, cases involving derivative suits decided prior to 1966 are controlling for the purposes of applying the notice requirements of Rule 23.1. See 7A Wright & Miller, Federal Practice and Procedure 427 (1972).

[8] As Professor Moore writes:

"Although voluntary dismissal by the plaintiff or by stipulation under Rule 41(a)(1) is expressly made subject to the provisions of Rule 23(e), and Rule 41(a)(1) fails to make a comparable exception for Rule 23.1 and Rule 23.2, this is an inadvertent omission. The specific requirement in Rule 23.1 for notice and court approval controls over the generality of Rule 41(a)(1) and must be observed in cases where it applies." 3B Moore's Federal Practice ¶23.1.24[2] (1969).

we have held that a plaintiff-stockholder's consent to the entry of summary judgment against him is analogous to a voluntary dismissal and triggers the notice requirements of Rule 23.1. *Certain-Teed Products Corp.* v. *Topping*, 171 F.2d 241, 243 (2 Cir. 1948). See also *Goldfarb* v. *Ehlers*, CCH Fed. Sec. L. Rptr. ¶93,382 (E.D.N.Y. 1972); *Brendle* v. *Smith*, 7 F.R.D. 119, 120 (S.D.N.Y. 1946); *Winkelman* v. *General Motors Corp.*, *supra*, 39 F.Supp. at 830-31.

There are cogent reasons for requiring notice of proposed voluntary dismissals and settlements of derivative actions. Notice is essential in these situations to ensure that the dismissal of the derivative suit is in the best interests of the corporation and the absent stockholders. See *Norman* v. *McKee*, 431 F.2d 769, 774 (9 Cir. 1970), *cert. denied*, 401 U.S. 912 (1971); *Cohen* v. *Young*, 127 F.2d 721, 726 (6 Cir. 1942), *cert. denied*, 321 U.S. 778 (1944). More specifically, notice and court approval of settlements under Rule 23.1 discourage private settlements under which the plaintiff-stockholder and his attorney profit to the exclusion of the corporation and nonparty stockholders. See *Wolf* v. *Barkes*, 348 F.2d 994, 996 (2 Cir.), *cert. denied*, 382 U.S. 941 (1965); *Birnbaum* v. *Birrell*, 17 F.R.D. 409, 411 (S.D.N.Y. 1955); *Craftsman Finance & Mortgage Co., Inc.* v. *Brown*, 64 F.Supp. 168, 178 (S.D.N.Y. 1945). Without the requirements of notice and court approval, there would be a greater incentive for stockholders to bring strike suits, and it would be easier for alleged wrongdoers to "buy off" the corporation's representative. Moreover, the notice provisions of Rule 23.1 have been interpreted to apply to a voluntary dismissal and to a dismissal following consent to the entry of summary judgment in order to prevent such dismissals from being a cloak for a collusive settlement between the plaintiff-stockholder and the defendants. See 7A Wright & Miller, Federal Practice and Procedure 435 (1972).

Aside from limiting the opportunities for collusion, there are persuasive reasons for requiring notice to nonparty stockholders of a proposed voluntary dismissal. Assuming that the plaintiff-stockholder is attempting to enforce a valid corporate claim, the Rule 23.1 safeguards will protect the corporation and absent stockholders from a plaintiff who becomes "fainthearted" prior to the completion of litigation and wishes to settle the derivative suit even though such a disposition would not be in the best interests of the corporation. See *Webster Eisenlohr, Inc.* v. *Kalodner*, 145 F.2d 316, 320 (3 Cir. 1944), *cert. denied*, 325 U.S. 867 (1945); *Marcus* v. *Textile Banking Co.*, 38 F.R.D. 185, 187 (S.D.N.Y. 1965). Similarly, notice to nonparty stockholders of voluntary dismissals protects against prejudice to the corporation from discontinuance of a derivative suit after the plaintiff-stockholder has already secured an advantage or when the statute of limitations precludes the institution of a new suit. See McLaughlin, *Capacity of Plaintiff-Stockholder to Terminate a Stockholder's Suit*, 46 Yale L.J. 421, 428 (1936). In these situations, notice enables other stockholders to intervene to protect the corporate claim and to continue the litigation if that seems advisable.

The policy considerations which support requiring notice of a proposed voluntary dismissal are not applicable when the corporate claim is dismissed after a hearing on the merits. Litigation upon the merits substantially reduces the opportunities for collusion between the plaintiff-stockholder and the defendants. A contest upon the merits is presumed to indicate that the plaintiff-stockholder vigorously prosecuted the claim on behalf of the corporation. Accordingly, the Rule 23.1 notice provisions do not apply to dismissals following litigation upon the merits. See *Daugherty* v. *Ball*, 43 F.R.D. 329, 335 (C.D. Calif. 1967); 3B Moore's Federal Practice ¶23.1.24[2] (1969); 7A Wright & Miller, Federal Practice and Procedure 436 (1972).

See also *Pelelas* v. *Caterpillar Tractor Co.*, 113 F.2d 629, 633 (7 Cir.), *cert. denied*, 311 U.S. 700 (1940) (class action); *Hutchinson* v. *Fidelity Ins. Ass'n.*, 106 F.2d 431, 436 (4 Cir. 1939) (class action); *Dolgow* v. *Anderson*, 53 F.R.D. 664, 690 (E.D.N.Y. 1971) *aff'd*, —— F.2d —— (2 Cir. 1972), slip op. 3615 (June 20, 1972) (class action). Even without notice, a dismissal after a hearing on the merits is a binding adjudication of the corporate claim and precludes nonparty stockholders from bringing a subsequent derivative suit based on the same cause of action. *Ratner* v. *Paramount Pictures, Inc.*, 6 F.R.D. 618, 619-20 (S.D.N.Y. 1942).

A dismissal for failure to answer interrogatories cannot accurately be characterized as either a voluntary dismissal or a dismissal following a hearing on the merits. True, it has some attributes of a dismissal following litigation upon the merits. The plaintiff-stockholder does oppose the dismissal.[9] Moreover, as there is no initial bar to reaching the merits, the defendants may be put to the inconvenience of preparing to defend on the merits. See *Costello* v. *United States*, *supra*, 365 U.S. at 286. Furthermore, dismissals for failure to answer interrogatories are based in part upon the presumption that the plaintiff's alleged cause of action is without merit. See *Hammond Packing Co.* v. *Arkansas*, 212 U.S. 322, 349-54 (1909). Nevertheless, on balance, we believe that dismissals of derivative suits for failure to answer interrogatories are more analogous to voluntary dismissals. Thus, if prior dismissals for failure to comply with discovery orders

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[9] Of course, if the *White* plaintiffs had consented to the dismissal for failure to answer interrogatories, the dismissal would have been voluntary and notice clearly would have been required. See *Certain-Teed Products Corp.* v. *Topping*, *supra*, 171 F. 2d at 243; *Winkelman* v. *General Motors Corp.*, *supra*, 39 F. Supp. at 830-31. Here the *White* plaintiffs did not consent to the dismissal.

are to be given *res judicata* effect, notice of the proposed dismissal must be given to nonparty stockholders.

The policy considerations which compel the giving of notice prior to voluntary dismissals are equally applicable to dismissals for failure to answer interrogatories. Similar to the reasons for extending the notice provisions of Rule 23.1 to a dismissal following consent to the entry of summary judgment, a dismissal for failure to answer interrogatories could easily disguise a collusive settlement.[10] To permit dismissal without notice for failure to comply with a discovery order would provide a simple technique whereby fraudulent directors or officers could avoid future liability by having a complaint stockholder sue and withdraw at an appropriate moment. Moreover, notice of a proposed dismissal for failure to answer interrogatories will protect the corporation and absent stockholders from a plaintiff-stockholder who, for reasons unrelated to the merits of the corporate claim, chooses not to comply fully with a discovery order. For example, it must be remembered that a plaintiff-stockholder generally finances the prosecution of the derivative suit out of his own pocket and will not be reimbursed unless successful. Such a person may decide that the financial risk is too great to justify expending large sums of money to supply complete answers to interrogatories. Requiring notice under Rule 23.1 in these situations affords nonparty stockholders an opportunity to intervene to prosecute the suit to its completion.

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[10] We do not suggest that in the instant case there was any collusion between the *White* plaintiffs and the defendants. The district court specifically noted: "There is not the slightest suggestion of any impropriety in the motions to dismiss and in the dismissal of the White action; the Court at the time was fully advised in the premises." 333 F. Supp. at 1087.

Even aside from the Rule 23.1 notice provisions, there is an additional reason for our reluctance to accord *res judicata* effect to the judgment in the *White* action. If we were to apply the general principles of Rule 41(b) and hence to bar the present suit, a serious due process question would arise. The rationale for binding nonparty stockholders to a judgment in a derivative action is that a plaintiff-stockholder represented their interests in that litigation. If nonparty stockholders are to be conclusively bound by the results of an action prosecuted by a stockholder ostensibly representing their interests, however, fundamental considerations of fairness and justice demand that the representation be adequate. Cf. *Hansberry* v. *Lee*, 311 U.S. 32, 44-46 (1940). One of the principal criteria for adequacy of representation is that the representation must be of such character as to insure the vigorous prosecution of the claim. Cf. *Eisen* v. *Carlisle & Jacquelin*, 391 F.2d 555, 562-63 (2 Cir. 1968) (class action); *Fogel* v. *Wolfgang*, 47 F.R.D. 213, 216 (S.D.N.Y. 1969) (class action); *Dolgow* v. *Anderson*, 43 F.R.D. 472, 494 (E.D.N.Y. 1968), *rev'd on other grounds*, 438 F.2d 825 (2 Cir. 1970) (class action). As the court said in *Mersay* v. *First Republic Corp. of America*, 43 F.R.D. 465, 470 (S.D.N.Y. 1968) (class action):

> "[T]he primary criterion is the forthrightness and vigor with which the representative party can be expected to assert and defend the interests of the members of the class, so as to insure them due process."

The fact that the *White* action was dismissed for failure to answer interrogatories raises some doubt as to whether the *White* plaintiffs provided the type of representation necessary to satisfy the dictates of due process. The uncertainty about the adequacy of the representation is in-

creased somewhat by the Special Master's conclusion that the *White* plaintiffs were "not serious in prosecuting this action . . ." and by the First Circuit's decision in *Moses* v. *Burgin, supra,* note 3, which held that claims similar to those asserted in the *White* action could constitute violations of the Investment Company Act of 1940. Since we hold that failure to give notice to nonparty stockholders precludes according *res judicata* effect to the *White* action, we do not have to decide whether the *White* plaintiffs failed to provide adequate representation.

Affirmed.

Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the first day of August one thousand nine hundred and seventy-two.

Present: HON. HAROLD LEVENTHAL,
HON. WILFRED FEINBERG,
HON. WILLIAM H. TIMBERS,
Circuit Judges.

Paulette Papilsky,
Plaintiff-Appellee,

v.

Alvin H. Berndt, Robert S. Driscoll, Carl W. Knobloch, Glenn A. Lloyd, James H. Potter, Paul W. H. Trevor, Paul Windels, Jr., Lord, Abbett & Co., and Affiliated Fund, Inc.,
Defendants,

Alvin H. Berndt, Robert S. Driscoll and Lord, Abbett & Co.,
Defendants-Appellants.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed with costs to be taxed against the appellants.

A. DANIEL FUSARO
Clerk